Nova Scotia Municipal Finance Corporation

21st Annual Report
2001

Nova Scotia

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How the Corporation Functions

Authority

The Nova Scotia Municipal Finance Corporation was established by an act of the Legislature of the Province of Nova Scotia in 1979, being Chapter 301 of the Revised Statutes of Nova Scotia, 1989.

Purpose and Mission

The Corporation's purpose is to provide financing for the capital requirements of municipalities, school boards, and hospitals by issuing its securities and relending the funds for these purposes. It is currently the policy that both school and hospital construction debt will be financed directly by the Province of Nova Scotia.

All municipalities and school boards must finance, and hospitals may finance, their capital requirements through the Corporation, except for capital projects funded directly by the Province of Nova Scotia, interim financing, and certain projects for which funds may be borrowed from the Government of Canada, the Province, or other municipalities within the province.

The Corporation's mission is to utilize credit enhancement and debt-pooling techniques to meet clients' approved funding requirements at the lowest possible cost.

Administration

The affairs of the Corporation are managed by a Board of Directors appointed by the Governor-in-Council. Forty per cent of the members are appointed upon the recommendation of the Union of Nova Scotia Municipalities.

The administrative budget approved by the Minister of Service Nova Scotia and Municipal Relations may be cost-shared by the Province in such proportion as the Governor-in-Council may prescribe in any year. The remainder of the approved administrative expenses is to be paid by the Corporation and/or the borrowing units.

Support staff and resources of the provincial Departments of Finance, Justice, and Service Nova Scotia and Municipal Relations have been provided to the Corporation.

Office location:
Suite 208, 1601 Lower Water Street
Halifax, Nova Scotia B3J 1S2

Mailing address:
PO Box 850, Station M
Halifax, Nova Scotia B3J 2V2

Telephone: (902) 424-4590
Fax: (902) 424-0525
Website: http://www.gov.ns.ca/nsmfc/

Directors and Officers

(as at March 31, 2001)

Directors of the Corporation

Brian Stonehouse, PEng, Chair
Deputy Minister
Service Nova Scotia and Municipal Relations

James E. Radford, MBA, CA
Business Consultant, Halifax, Nova Scotia

Richard G. Ramsay, MPA
Business Consultant, Port Williams, Nova Scotia

Clint Schofield
Councillor
Halifax Regional Municipality

Douglas P. Stratton, CFA, Executive Director
Investments, Pensions and Treasury Services
Department of Finance

Officers of the Corporation

Chair
Brian Stonehouse, PEng
Deputy Minister
Service Nova Scotia and Municipal Relations

Chief Executive Officer and Treasurer
R. Mark Gilbert, MBA, PhD

Corporate Secretary
Jane Fraser-Coutts
Director, Advisory Services
Service Nova Scotia and Municipal Relations

General Counsel
John Traves, LLB
Director, Solicitor Services
Department of Justice

Assistant Treasurer
Roy Spence
Director, Debt and Liability Management
Department of Finance

Directors' Report

Business Plan

The Corporation's Board of Directors approved a business plan for the 2000–2001 fiscal year. The plan reaffirms our mission statement, which is "to utilize credit enhancement and debt-pooling techniques to meet clients' approved funding requirements at the lowest possible cost." This is achieved through the issuance of debentures. The Corporation pools municipal borrowing requirements, which eliminates the need for individual municipalities to negotiate and administer their own debenture issues. Under the Municipal Finance Corporation model, the debt issuance function remains in the public sector domain.

This business plan features three strategic goals, which are identified below. The outcomes, indicators, measures, and results are included.

Strategic Goal 1. To work with clients, the Province, and the investment community in providing capital financing to our clients at the lowest cost of funds available for their particular debt structure and timing needs.

Outcome. Meeting approved client financing requirements.
Indicator. Response to approved requests for financing

Measures
- Percentage of formal requests complied with through the debenture issue immediately following the request
- Average response time to formal requests, measured in weeks

Results
The Corporation responded to all client requests in a timely fashion by pricing issues within six to seven weeks of formal municipal requests. This length of time is a result of the need for both MFC and the Province to pre-approve the parameters used when negotiating the debenture issues.

Additional results
The Corporation
- issued $52,413,000 in debentures and on-loaned a similar amount to clients
- administered $706,000 in short-term financing pending issuance of a debenture
- administered $617 million in outstanding debentures, which included the payment of debenture interest
- administered $613 million in outstanding loans to municipalities, school boards, and hospitals
- invested and administered pooled sinking fund trusts valued at $100 million

Strategic Goal 2. To explore and develop new methods and products for meeting the needs of our clients through contact with the investment community, the public sector, and academic research.

Outcome. Awareness of new loan features that may benefit clients.
Indicator. Amount of communication with clients, investment community, academics, and public sector counterparts

Measure. Percentage of potential borrowers contacted

Results. Conducted 15 field visits (25 per cent of municipal units and other active clients) during the year
Additional results

- The MFC/interdepartmental/municipal committee to explore municipal interest and the practicalities of developing a pooled lease-financing program for Nova Scotia municipalities completed its work and presented its findings to interested parties.
- The Corporation was represented on implementation committees relating to the Provincial/Municipal Roles and Responsibility review initiative.
- The Corporation provided advice to the consultant responsible for the financial evaluation of a large municipal capital project.
- Meetings were held with the Corporation's lead managers and other members of the investment community, staff of the Nova Scotia Department of Finance, and other municipal finance corporations to discuss trends and developments in municipal capital financing.
- The NSMFC website was improved.

Strategic Goal 3. To promote responsible and professional approaches to municipal capital-project planning and financing (jointly with Service Nova Scotia and Municipal Relations).

Outcome. Optimum use of capital funds and improved community infrastructure.
Indicator. Information on capital planning and finance

Measure. Percentage of borrowers with a capital budgeting, planning, and finance strategy

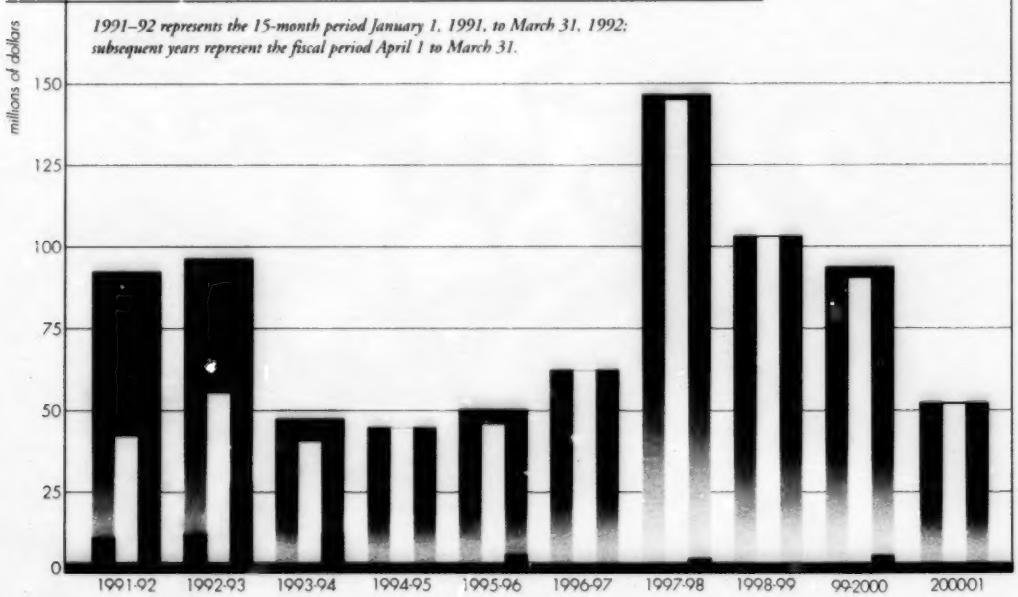
Results. In progress
Additional results
The Corporation

- conducted 15 field visits during the year
- worked with staff of Service Nova Scotia and Municipal Relations and/or municipal staff in developing responses to municipal capital-financing proposals
- responded to the information needs of municipalities and the investment community

Strategic Goal 3. To prudently manage all financial aspects of the Corporation, including credit risk and asset/liability management.

Long-Term Loans Made During Year

1991–92 represents the 15-month period January 1, 1991, to March 31, 1992; subsequent years represent the fiscal period April 1 to March 31.



	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	99-2000	200001
Hospital	9.3	11.7	—	—	—	—	—	—		—
Municipal	36.4	54.0	36.7	46.9	49.0	62.9	145.4	105.1	84.5	52.4
School Board	36.1	26.1	11.9	—	2.1	—	1.4	—	2.5	—
Total	81.8	91.3	48.6	46.9	51.1	62.9	146.8	105.1	87.0	52.4

Note: The amount of debentures issued during the year approximates the long-term loans made.

Outcome. Matching of assets and liabilities
Indicator. Information on MFC pooled debenture issues and loans to municipal clients

Measure. Similarity of aggregate amounts, terms, and timing of debentures and loans to units

Results. Matched the amount, term, and timing of MFC debentures and loans to units.
Additional results

- The Corporation obtained verification of creditworthiness from Service Nova Scotia and Municipal Relations prior to setting the parameters for pooled issues.

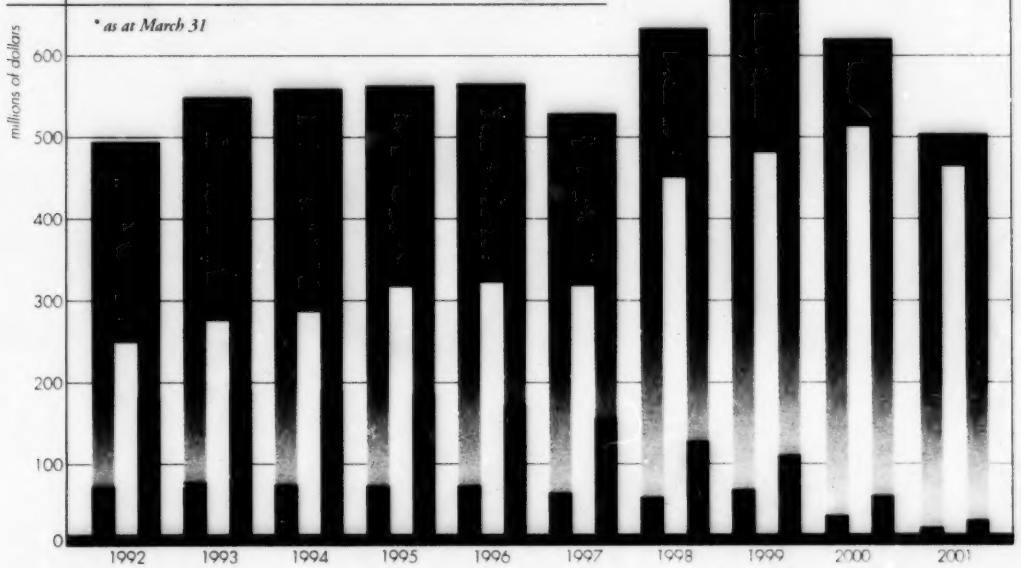
Projects Administered

	Service Nova Scotia and Municipal Relations	Education
Schools	—	$ 0
Water	$ 10,397,600	
Sewer	2,668,100	
Streets	13,048,060	
Buildings	8,469,640	
Land	1,575,000	
Electric	—	
Equipment, vehicles, IT	2,798,595	
Parks and recreation	3,585,590	
Solid waste	4,411,242	
Sewage treatment	2,966,725	
Transit	2,490,700	
	$ 52,411,252	$ 0
Number of loans	31	

Loans to Municipal Units and School Boards

The Corporation's loan portfolio comprises loans to school boards and hospitals that are serviced by the Province of Nova Scotia and loans to municipal units and enterprises that are serviced or guaranteed by Nova Scotia municipalities. There are no arrears. Service Nova Scotia and Municipal Relations performs the credit check using ministerially approved debt policy guidelines, and the Minister approves all capital loans to municipal units and enterprises. The Corporation's interest rate risk is minimized by matching the interest rates, term, and features of its debenture issues with those on the loans it makes to its clients.

Loans to Municipal Units, School Boards, and Hospitals



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Hospital	62.5	71.6	69.0	66.4	63.7	63.0	53.9	53.9	35.3	11.8
Municipal	249.2	274.9	289.6	312.0	329.0	319.9	449.3	493.7	508.9	463.4
School Board	183.5	197.0	195.4	181.0	169.6	153.4	128.6	116.2	68.3	25.0
Total	495.2	543.5	554.0	559.4	562.3	536.3	631.8	663.8	612.5	500.2

Note: The amount of debentures outstanding at the end of each year approximates the loans Outstanding Borrowing Program.

During the year, long-term loans totalling $52,411,252 were made to 26 municipal units and municipal enterprises. They were used for the purposes shown above.

An interim loan of $706,000 was made during the year to one municipal enterprise. This loan will be repaid from the proceeds of a long-term loan made to this unit as part of the pooled debenture issue in the spring of 2001.

The accumulated loans outstanding at March 31, 2001 amount to $500.2 million, comprising $463.4 million to 64 municipal units and enterprises, $25.0 million to 21 school boards, and $11.8 million to three hospitals. Effective March 31, 1993, the Province of Nova Scotia assumed all loans related to shareable school and hospital construction. The chart on page 4 shows the total loans outstanding at the end of each of the last 10 fiscal years, broken down by category.

Borrowing Program

Funds totalling $52.4 million for the loans for municipal and school purposes were raised through two issues in the Canadian domestic market. Both issues were placed privately with the Province of Nova Scotia, which purchased a $26.7 million issue in June and a $25.7 million issue in November. Interest rate coupons ranged from 5.875 per cent to 6.875 per cent.

Sinking Fund Assets

Cash and short-term investments	$	248,235
Accounts receivable		124
Accrued interest		477,231
Investments, at amortized cost		19,369,191
	$	20,094,781

Fund Continuity

Balance of sinking funds—April 1, 2000	$	100,318,480
Installments received		9,596,770
Income earned		3,961,267
Payout of matured loans		(93,781,736)
Balance of sinking funds—March 31, 2001	$	20,094,781

Trust Funds under Administration

The Corporation administers sinking funds on behalf of borrowers. These sinking funds, which relate to 20 individual loans totalling $24.6 million, are to be applied to the repayment of these loans at maturity.

A summary of the continuity of the balance of the sinking funds for the year is shown at the bottom of the page.

Investments are purchased in accordance with the investment policy of the Board of Directors and are recorded in the financial statements at their amortized cost. Discounts and premiums on the purchase of securities are amortized over the remaining term to maturity. The investment policy includes guidelines for matching sinking fund assets and liabilities.

At March 31, 2001, the investment portfolio included securities of the Province of Nova Scotia and its guarantees (55 per cent), other provinces and their guarantees (28 per cent), and municipalities (17 per cent).

The average rate of return earned on the combined sinking funds was 6.8 per cent this fiscal year.

Acknowledgements

We acknowledge the administrative support and co-operation received from the Departments of Education, Finance, Justice, and Service Nova Scotia and Municipal Relations. Each of these departments has contributed the services of staff, which provides considerable assistance to the Corporation. The Directors wish to thank the staff of the Corporation for their excellent contribution.

Management's Responsibility for Financial Statements

The financial statements of Nova Scotia Municipal Finance Corporation are the responsibility of management and have been prepared in accordance with CICA's accounting principles, which are generally accepted in Canada, applied on a basis consistent with that of the preceding year. The financial information presented elsewhere in the annual report is consistent with the financial statements and the underlying information from which these financial statements were prepared.

The financial statements have been examined independently by the external auditors, KPMG, whose responsibility it is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditors' Report, attached to the financial statements, outlines the scope of their examination and contains their opinion.

Provincial procurement policy requires that provincial Crown corporations utilize a competitive bidding process for goods and services. The Corporation's previous audit contract expired at the end of the 1996–97 fiscal year. A request for proposals for audit services for a five-year period beginning in the 1997–98 fiscal year was issued by the Corporation. KPMG's proposal was the most competitive and was accepted by the Board of Directors.

The financial statements and all information in the Annual Report have been approved by the Board of Directors. The external auditors have full and free access to the Board, with and without the presence of management, to discuss auditing, internal control, accounting policy, and financial reporting matters.

Auditors' Report to the Directors

We have audited the balance sheet of Nova Scotia Municipal Finance Corporation as at March 31, 2001 and the statements of revenue, expenditure and reserve fund and cash flows for the year then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at March 31, 2001 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Halifax, Canada
May 4, 2001

Balance Sheet

March 31, 2001, with comparative figures for 2000

	2001	2000
Assets		
CURRENT ASSETS:		
Cash	$ 41,649	$ 3,160
Short-term investments, at amortized cost (market — $4,959,659; 2000 — $2,040,000)	4,959,659	2,040,000
Accrued interest receivable	12,024,608	16,439,252
Other receivables	1,655	7,333
Principal due within one year on loans to units	68,328,704	161,176,120
	85,356,275	179,665,865
LONG-TERM ASSETS:		
Loans to units (note 3)	500,206,012	612,502,241
Less principal included in current assets	68,328,704	161,176,120
	431,877,308	451,326,121
Investments, at amortized cost (market — $756,187; 2000 — $6,939,664)	773,549	6,918,921
	432,650,857	458,245,042
DEFERRED CHARGES:		
Discount on debenture debt	2,532,143	3,634,465
Less accumulated amortization	1,507,223	2,503,950
	1,024,920	1,130,515
	$ 519,032,052	$ 639,041,422
TRUST FUND ASSETS *(note 4)*	$ 20,094,782	$ 100,319,585

Liabilities and Equity

	2001	2000
CURRENT LIABILITIES:		
Accounts payable	36,844	34,612
Accrued interest payable	12,014,170	16,449,585
Principal due within one year on debenture debt	69,064,750	165,792,750
	81,115,764	182,276,947
LONG-TERM DEBT:		
Debentures payable (note 5)	501,313,250	616,943,000
Less principal included in current liabilities	69,064,750	165,792,750
	432,248,500	451,150,250
DEFERRED CREDITS:		
Discount on loans to units	2,523,323	3,666,568
Less accumulated amortization	1,513,830	2,556,513
	1,009,493	1,110,055
EQUITY:		
Reserve Fund:		
Residual Reserve Funds	4,658,295	4,361,670
Reserve for debenture/loan interest differential	–	142,500
	4,658,295	4,504,170
	$ 519,032,052	$ 639,041,422
TRUST FUNDS UNDER ADMINISTRATION *(note 4)*	$ 20,094,782	$ 100,319,585

See accompanying notes to financial statements.

Approved on behalf of the Board:

Director

Director

Statement of Revenue, Expenditure & Reserve Fund

Year ended March 31, 2001, with comparative figures for 2000

	2001	2000
REVENUE:		
Interest on loans to units	$ 40,860,550	$ 50,259,635
Amortization of discount on loans to units	223,660	252,374
Interest on short-term investments	410,616	674,325
Current discount on loans to units	328,080	522,862
	41,822,906	51,709,196
EXPENDITURE:		
Interest on debenture debt and short-term loans	41,015,750	50,907,275
Amortization of discount on debenture debt	228,703	263,999
Debenture issue expenses	197,150	305,344
Administrative expenses	227,178	208,691
	41,668,781	51,685,309
NET REVENUE	154,125	23,887
RESERVE FUND, BEGINNING OF YEAR	4,504,170	4,480,283
RESERVE FUND, END OF YEAR	$ 4,658,295	$ 4,504,170

See accompanying notes to financial statements.

Statement of Cash Flows

Year ended March 31, 2001, with comparative figures for 2000

	2001	2000
CASH PROVIDED BY (USED IN):		
Operations:		
Net revenue	$ 154,125	$ 23,887
Add (deduct) items not involving cash:		
Amortization of discount on loans to units	(223,660)	(252,375)
Amortization of discount on debenture debt	228,703	263,999
Amortization of discount on investments	(23,440)	(106,529)
Change in non-cash working capital (note 7)	(12,861)	(47,898)
	122,867	(118,916)
INVESTMENTS:		
Issue of loans of $52,411,252 to units on security of debentures, net of discounts of $123,097 (2000 — $86,956,561 net of discounts of $186,295)	(52,288,155)	(86,770,266)
Principal received on loans to units	164,707,481	138,251,338
Principal received on maturing investments	6,925,000	
Purchase of investments of $840,814, net of discounts of $84,626	(756,188)	
	118,588,138	51,481,072
FINANCING:		
Issue of debentures of $52,413,000, net of discounts of $123,107 (2000 — $86,958,000 net of discounts of $186,376)	52,289,893	86,771,624
Principal payment on debenture debt	(168,042,750)	(139,466,000)
	(115,752,857)	(52,694,376)
INCREASE (DECREASE) IN CASH POSITION	2,958,148	(1,332,220)
CASH POSITION, BEGINNING OF YEAR	2,043,160	3,375,380
CASH POSITION, END OF YEAR	$ 5,001,308	$ 2,043,160

Cash position is defined as cash and short-term investments less bank indebtedness.

See accompanying notes to financial statements.

Notes to Financial Statements

Year ended March 31, 2001

The Corporation was created by the Municipal Corporation Act which was proclaimed on July 31, 1979. The Corporation began operations on January 1, 1980 and has a March 31 fiscal year-end. The object of the Corporation is to provide financing of approved capital projects for municipalities, municipal enterprises, including district school boards, and hospitals through a central borrowing authority.

1 Summary of significant accounting policies:

(a) Discounts on debenture debt and loans to units are being amortized over the life of the debentures payable and the loans receivable to which they relate, using the debentures outstanding method.

(b) The Reserve Fund was created from interest earnings on funds which had been advanced by the Province of Nova Scotia and have since been repaid and interest on other surplus monies available from time to time, as well as from discounts on loans to units. The purpose of the Reserve Fund is to provide a capital base for the Corporation, as well as to provide for funds which may be required for administrative purposes and timing differences.

(c) The Reserve for debenture/loan interest differential represented an allocation approved by the Board of Directors to fund the negative interest on certain loans. The majority of these loans have now matured, therefore the reserve is no longer required.

2 Fair values of financial instruments:

Financial assets and financial liabilities:

The fair values of cash, accrued interest receivable, other receivables, accounts payable, accrued interest payable and principal due within one year on loans to units and debenture debt are assumed to approximate their carrying amounts because of their short-term to maturity. The fair values of investments are assumed to approximate quoted market values as disclosed in the financial statements.

The fair values of the Corporation's loans to units and debentures payable fluctuate with changes in current lending rates. The Corporation's mandated rate of interest charged on loans to units is directly correlated to its cost of borrowing, thereby providing a hedge against equity erosion. As at March 31, 2001, the Corporation's debenture debt was hedged by offsetting loans to units with the exception of $1,107,238 which was hedged by promissory notes. The fair market value of the promissory notes was $1,394,405, while the fair market value of the debentures in excess of the loans to units was $1,154,733. As the Corporation normally holds the debentures to maturity, book values of the investments and debentures have not been adjusted to reflect the differences.

Trust fund assets managed by the Corporation are completely offset by trust fund liabilities providing a hedge against fair value changes.

3 Loans to units:

(a) Loans to units are made on the security of their debentures, due in annual instalments for periods up to a maximum of twenty years. Interest rates on the loans range from 1.00% to 12.5%. Due to existing provision for the recovery of any defaults by units, an allowance for doubtful accounts is not required.

(b) Principal payments receivable in each of the next five years are as follows:

2002	$ 68,328,704
2003	90,111,995
2004	50,937,881
2005	51,125,239
2006	50,724,445

4 Trust funds under administration:

Trust fund assets totalling $20,094,782 (2000 - $100,319,585) are held on behalf of certain municipal units and provincial debt issued for school and hospital construction. These funds represent sinking funds which are held by the Corporation to be applied to the repayment of outstanding debenture debt at maturity.

5 Debentures payable:

(a) The debenture debt outstanding at March 31, 2001 totalling $501,313,250 (2000 - $616,943,000) is in Canadian funds and is fully guaranteed by the Province of Nova Scotia except for Series AT which is a private placement.

Series	Date issued	Maturity date	Interest rate	Debt outstanding
N	Apr. 2/85	2001 to 2005	12.375-12.500	$ 2,930,000
AA	May 29/91	2001	10.500	7,600,000
AB	Oct. 30/91	2001	9.750	5,785,000
AC	May 13/92	2001 to 2002	9.875	31,850,000
AD	Dec. 9/92	2001 to 2002	8.500	11,400,000
AE	May 5/93	2001 to 2003	8.250-8.500	8,900,000
AF	Nov. 18/93	2001 to 2003	7.375-7.625	7,070,000
AG	July 13/94	2001 to 2004	9.000-9.250	8,550,000
AH	Dec. 8/94	2001 to 2004	9.375-9.750	13,940,000
AI *	May 2/95	2001 to 2005	8.875-9.125	10,475,000
AJ	Nov. 14/95	2001 to 2005	7.750-8.125	18,690,000
AK *	May 14/96	2001 to 2006	7.250-8.000	28,864,000
AL	Oct. 28/96	2001 to 2006	6.750-7.500	14,188,000
AM *	May 12/97	2001 to 2007	6.250-7.000	44,208,000
AN *	Oct. 17/97	2001 to 2007	5.250-6.250	31,698,000
AP *	Jan. 30/98	2002 to 2019	5.375-6.125	42,025,000
AQ	May 15/98	2001 to 2008	5.125-5.500	33,182,000
AR *	Dec. 1/98	2001 to 2008	5.125-5.625	49,946,000
AS *	May 17/99	2001 to 2009	4.875-5.375	35,345,000
AT	May 28/99	2001 to 2015	1.000	2,531,250
AU *	Dec. 22/99	2001 to 2009	6.250-6.750	39,723,000
AV *	June 1/00	2001 to 2010	6.250-6.875	26,760,000
AW *	Nov. 9/00	2001 to 2010	5.875-6.375	25,653,000
				$ 501,313,250

**Placed directly with the Province of Nova Scotia*
Interest is payable semi-annually, except Series AT which is payable annually.

(b) Principal payments due in each of the next five years are as follows:

2002	$ 69,064,750
2003	90,912,750
2004	50,846,750
2005	51,080,750
2006	50,687,750

6 Taxes:

The Corporation is not subject to provincial or federal taxes.

7 Change in non-cash working capital:

	2001	2000
Accrued interest receivable	$ 4,414,644	$ 3,285,340
Other receivables	5,678	(7,333)
Accounts payable	2,232	12,221
Accrued interest payable	(4,435,415)	(3,338,126)
	$ (12,861)	$ (47,898)